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April 25, 2005

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*By Hand Delivery*

Ms. Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 12<sup>th</sup> St, S.W., TW-B204  
Washington, D.C. 20554

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APR 25 2005

Federal Communications Commission  
Office of Secretary

**Re: WC Docket No. 05-65 – In the Matter of SBC  
Communications Inc. and AT&T Corp. Applications for  
Approval of Transfer of Control**

Dear Ms. Dortch:

Qwest Communications International Inc. ("Qwest"), by its attorneys and pursuant to the Commission's *Public Notice* (DA 05-656) and *Order Adopting Protective Order* (DA 05-635) in the above-referenced proceeding, submits herewith (1) the original of its unredacted, confidential comments, and (2) the original and one copy of its redacted, public comments in connection with the proposed merger of SBC Communications Inc. and AT&T Corp.

Pursuant to Commission's *Order Adopting Protective Order*, Qwest separately is submitting two copies of its unredacted, confidential comments to Gary Remondino of the FCC's Wireline Competition Bureau's Policy Division.

Each page of the Qwest's confidential submission is appropriately stamped pursuant to the *Order Adopting Protective Order*. Inquiries regarding access to Qwest's confidential submission (subject to the terms of the Protective Order) should be addressed to the following:

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Letter to Ms. Dortch  
April 25, 2005  
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Please contact the undersigned if you have any questions concerning this submission.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Yaron Dori', written in a cursive style.

Yaron Dori

cc: J. Bird  
B. Dever  
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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of	)	
	)	
SBC Communications Inc. and	)	
AT&T Corp.	)	WC Docket No. 05-65
	)	
Applications for Consent to	)	
Transfer of Control	)	

PETITION TO DENY OF  
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April 25, 2005

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**DECLARATION OF B. DOUGLAS BERNHEIM**

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
SBC Communications Inc. and	)	
AT&T Corp.	)	
	)	WC Docket No. 05-65
Applications for Consent to	)	
Transfer of Control	)	
	)	
To: The Commission	)	

**PETITION TO DENY OF QWEST COMMUNICATIONS INTERNATIONAL INC.**

Qwest Communications International Inc. (“Qwest”) submits this petition to deny the application of SBC Communications Inc. (“SBC”) and AT&T Corp. (“AT&T”) for approval of their proposed merger (the “Merger Application” or “Application”). <sup>1/</sup> For the reasons explained below, this Application should be denied in its current form. The merger would permit SBC to foreclose current competition by acquiring its principal rival. Equally important, SBC would threaten emerging competition from wireless, VoIP and other broadband technologies by removing AT&T as a potential partner for other parties seeking to create fully integrated alternative services in the SBC region. These effects would be magnified by any concurrent Verizon-MCI combination.

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<sup>1/</sup> See Public Notice, *Commission Seeks Comment on Application for Consent to Transfer of Control Filed By SBC Communications Inc. and AT&T Corp.*, DA 05-656 (rel. March 11, 2005)

If the SBC-AT&T merger is not rejected, the Commission at least must condition it on substantial divestiture of AT&T facilities, customer contracts and related operations in the SBC territory. The Department of Justice was prepared to require such divestitures of Qwest just 14 months ago when the company proposed to acquire Allegiance Telecom, a national CLEC overlapping Qwest only in its five largest and most competitive in-region cities. Qwest does not concede that divestitures of this scope would have been appropriate for that relatively small deal. However, the SBC-AT&T merger is a “super-super-sized” version of the Qwest-Allegiance transaction. The merger here involves two much larger companies, and far more service overlap across the entire SBC region, with added competitive issues arising from SBC’s ownership of Cingular Wireless Corporation (“Cingular”). Thus, if this Application is not denied, it is even more necessary that the Commission require substantial divestiture.

## **I. INTRODUCTION AND SUMMARY**

### **A. The Commission Should Reject SBC’s Vision That Re-Concentration Is Inevitable**

This proceeding, and the related application of Verizon to acquire MCI, 2/ are perhaps the most significant dockets the Commission has faced since Divestiture. The nation’s two largest local exchange carriers, who already control the nation’s two largest wireless companies, now propose to acquire their two largest competitors in the wireline local and interexchange markets. If the mergers are allowed, these two giants would control 80% of the nation’s wireline

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2/ See *Application of Verizon Communications Inc. and MCI, Inc. for Approval of Transfer of Control*, WC Docket No. 05-75.

business market, more than 63% of all ILEC lines, and more than half of all wireless subscribers nationwide. <sup>3/</sup>

Ordinarily mergers resulting in such concentration levels would be rejected out of hand. They certainly fail the Communications Act's requirement that mergers "enhance or not retard competition." <sup>4/</sup>

SBC and Verizon respond to these facts by aggressively promoting a theme of inevitability. To listen to them, re-concentration with their largest competitors restores the natural order. They imply that it is impossible for AT&T and MCI to stand on their own. SBC and Verizon ask this Commission and other regulators to accept this vision of re-concentration as necessary and inevitable.

While singing this tune, SBC and Verizon blur or withhold key facts concerning the scope of the overlap that would be created by these mergers. They also ignore the adverse impact of the mergers on developing intermodal competition, even while dismissing the relevance of their control of the nation's largest wireless firms. They grossly exaggerate the ability of unaffiliated intermodal competitors to constrain the market power of the merged firms. SBC and Verizon also ignore just how little they compete in each other's regions today. They thus discourage Commission analysis of how elimination of their two main rivals would further magnify their incentives to engage in such mutual forbearance and create two durable regional monopolies. The two RBOCs imply, in short, that because the mergers are inevitable, regulators

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<sup>3/</sup> See *FCC Statistics of Communications Common Carriers, 2003/2004 Edition*, released Oct. 12, 2004, Table 2.1 (Total Access Lines); UBS Wireline Telecom Play Book, January 14, 2004, and company SEC filings; Deutsche Bank Data Book, Volume 8, March 2005 at 2.

<sup>4/</sup> *Applications of NYNEX Corporation, Transferor, and Bell Atlantic Corporation, Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, File No. NSD-L-96-10, *Memorandum Opinion and Order*, 12 FCC Rcd 19985, 20007 (¶ 36) (rel. Aug. 14, 1997) ("Bell Atlantic-NYNEX Merger Order").

do not need to spend time on rigorous review of actual markets today, or the impact of the mergers for the future.

Qwest has debated whether to participate in this docket. After all, it is a remarkable event for one RBOC to criticize the deal of another. However, we strongly reject the notion that a merger involving such remarkable concentration and harm to competition is “inevitable,” let alone in the public interest. Qwest has a much different vision. We believe that consumers are better served by application of standard competition analysis and rejection of these mergers. Importantly, we are not suggesting that AT&T and MCI will continue as they are today. All companies in this dynamic industry are evolving. But rejection of these two mergers would leave AT&T and MCI free to partner with other firms who are bringing new competition to SBC and Verizon through the possibilities of the Internet, convergence of technology and media platforms, and many other recent advances.

Put another way, SBC and Verizon are not merely trying to acquire their largest current competitors. They also are trying to eliminate – right here, right now, before it is too late – the threat that the assets of AT&T and MCI could be used against them in a converged world. SBC and Verizon are protecting themselves against the risk that developing intermodal threats could morph into meaningful, fully-integrated competitors in part through the use of AT&T and MCI facilities, customers, technical and marketing expertise, systems, and brands. If these mergers are approved, SBC and Verizon will not need to worry that AT&T and MCI may partner with smaller wireline companies, or wireless companies, or media companies, or internet companies, or computer companies, or power companies – or more likely some combination of the foregoing. Indeed, SBC and Verizon already have accomplished one stage in this self-defense process

through their wireless acquisitions. But elimination of AT&T and MCI would be an even more significant development.

Qwest is fully prepared for glib attacks from SBC and Verizon maligning our motives in commenting here. However, the Commission is well aware that Qwest is the only RBOC that has attempted to compete vigorously outside its region. Qwest also has facilitated competition inside its region through innovative wholesale products such as Qwest Platform Plus ("QPP") and naked DSL. We have been a national leader in the deployment of VoIP services. We embrace a vision of competition in which we partner with others to innovate and expand competitive choices for consumers. And while doing so, we have been recognized for the high level of our service quality by the Commission and in independent rankings. <sup>5/</sup>

Qwest also anticipates that SBC and Verizon will try to deflect our comments as mere fallout from our well-reported interest in a merger with MCI, so let us address that point head-on. First, we fully realize that it is not the Commission's concern whether Qwest and MCI merge, or what happens to either of those companies, or to any other particular competitor. This docket is about the public welfare. We also understand that under law the Commission may not reject the

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<sup>5/</sup> In December 2004, the Industry and Technology Division of the Wireline Competition Bureau released a report on the "Quality of Service of Incumbent Local Exchange Carriers." This report found that Qwest: (1) had the fewest number of initial trouble reports per thousand lines; (2) had fulfilled the highest percentage of residential installation commitments; and (3) had the shortest residential installation interval of all the RBOCs. *Id.* at 10, 13-14. This report further found that Qwest residential customers reported the lowest level of dissatisfaction with repairs and nearly the lowest level with installation. *Id.* at 12, 16. Finally, the report indicates that in the last five years Qwest has reduced the number of complaints it receives per million lines significantly more than any other RBOC. *Id.* at 9.

SBC-AT&T and Verizon-MCI transactions merely because the public would be better served by a different deal. 6/

But second, our interest in MCI is fully consistent with the public interest in a competitive telecommunications industry, and a strong independent competitor to SBC and Verizon. The vast majority of MCI's business is outside the Qwest region, and a combination of Qwest and MCI would create a company positioned to advance this competition across the country. The merged company would partner with other parties – as Qwest does today in reselling wireless services and opening up its DSL facilities to independent ISPs and carriers. We would have every incentive to support facilities bypass of the Verizon and SBC local networks.

Third, while we are gratified by the MCI Board's recent decision that Qwest's merger proposal is superior, that does not moot our concerns here. Control of MCI ultimately will be resolved by the MCI shareholders, as it should be. If Verizon does not acquire MCI, that would eliminate the competitive harms that would result from both of the nation's largest carriers acquiring their main rivals. But significant problems still would remain in the SBC region if that company is allowed to acquire AT&T without substantial divestitures.

Qwest is merely emphasizing the starting point for the statutory task before the Commission. As the Commission begins its merger review, it should immediately reject the "inevitability" theme of SBC and Verizon, for their proposed mergers are neither inevitable nor, as Qwest discusses below, lawful under the Communications Act. If these mergers are denied,

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6/ Thus, for example, it is not enough simply to observe that a combination of AT&T and a major media or computer company might lead to faster development of business and residential competition to SBC and Verizon, especially if that partnership then worked with a wireless firm with a greater incentive to deploy bypassing broadband wireless networks than Cingular or Verizon Wireless.

AT&T and MCI will not simply disappear. The enormous facilities investments they have sunk into the marketplace will not vanish. Instead, these companies will partner with other companies to compete with SBC and Verizon, just as other competitors of those two giants necessarily must partner in the complex world of convergence. AT&T and MCI may join with other firms through merger, contract, or joint venture (or some combination). They may partner with other wireline companies, wireless companies, ISPs, cable companies, or combinations of all of these players. But one way or another, the AT&T and MCI assets and experience will benefit consumers through independent competition in the SBC and Verizon territories. That is what SBC and Verizon fear most, and what they hope to preempt through these deals.

**B. Even the Preliminary Information Provided in the Application Demonstrates that the Merger Must Be Rejected Absent Substantial In-Region Divestiture**

When the Commission disregards SBC's self-serving vision of "inevitability," and evaluates the transaction in detail, it must find that the merger as structured fails the Commission's public interest standard. Qwest and other parties are hampered in commenting in detail here because SBC and AT&T have failed to disclose the information necessary for interested parties and the Commission to conduct that analysis in full. <sup>7/</sup> In particular, they have failed to provide detailed information regarding AT&T's overlapping facilities, customers and services in the 13 state SBC local exchange territory. <sup>8/</sup>

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<sup>7/</sup> Declaration of B. Douglas Bernheim (April 25, 2005) (hereinafter "Bernheim Declaration"), at ¶ 8.

<sup>8/</sup> SBC and AT&T and their supporting economists, Dr. Carlton and Dr. Sider, have failed to provide the data and information necessary for a meaningful economics analysis. Bernheim Declaration at ¶ 8.

The Wireline Competition Bureau has taken an important step to remedy this situation through its recent letter to SBC and AT&T setting forth an "Initial Information and Document Request" regarding matters discussed in the Applications. <sup>9/</sup> Qwest and other parties will be in a much better position to comment on the SBC-AT&T merger when the parties supplement the record.

Our comments here are necessarily preliminary, pending access to the data needed to conduct a meaningful analysis. We discuss the overall size and scope of the AT&T and SBC operations that would be consolidated by this merger. We discuss the harm to competition that the merger would cause, both in the context of existing competition, and to potential intermodal competition that SBC otherwise would face. And we discuss the incentives and ability of the merged SBC-AT&T and Verizon-MCI to engage in mutual forbearance that would further reduce competition in both the SBC and Verizon regions. In contrast, Qwest has competed aggressively out of region, and seeks to merge with MCI to become even stronger across the country.

While this analysis is limited by the data currently available from the parties, one point is very clear. This transaction cannot be approved unless SBC and AT&T substantially divest AT&T facilities, customer contracts, and other assets located in the SBC local exchange territory. Just 14 months ago the Justice Department would have required Qwest to agree to a similar divestiture in the context of our proposed acquisition of Allegiance Telecom, a CLEC providing service in just five of the largest and most competitive cities in our region. Qwest only would have been allowed to retain (1) Allegiance transport facilities crossing its regional boundaries, (2)

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<sup>9/</sup> Letter and attachment from Federal Communications Commission to Patrick J. Grant, counsel for SBC, and David L. Lawson, counsel for AT&T, dated April 18, 2005.

multi-region Allegiance customers served under a contract where over 50% of the revenue came from outside the Qwest region, and (3) certain operating systems used for both in-region and out-of-region service.

Qwest reserved the right to argue for a more limited divestiture, but the matter became moot when a third party made a higher offer for the company at a bankruptcy auction. We do not concede that the Justice Department was drawing the correct line last year given the limited market position of both Allegiance and Qwest. However, the SBC-AT&T merger presents much more significant competitive issues given the size of the two firms, the extent of their overlapping facilities and businesses, and SBC's ownership of Cingular. If SBC is to acquire AT&T, it will have to undertake a substantial divestiture of AT&T's assets and operations in its region. Qwest is in a very different position from SBC because its local service territory is far less populated, with few major business centers, because it does not own a major wireless company, and because only about 10% of MCI's business is in the Qwest region. Nevertheless, we realize that if we acquire MCI we will have to make appropriate divestitures as well.

These matters are discussed in more detail below, and Qwest looks forward to providing additional information after SBC and AT&T supplement the record. This proceeding is of the utmost importance for telecommunications consumers in this country. It will require extensive investigation. SBC and AT&T have not cooperated with that inquiry to date, with their stonewalling attitude toward divestiture, and even the basic facts. Now the Commission will have to fill the void and protect the public interest.

## II. THE COMMISSION SHOULD EVALUATE THIS MERGER WITH THE BENEFIT OF AT&T'S OWN PRE-MERGER ANALYSIS

The Commission has clearly articulated the burden of proof on applicants seeking authority to merge. Under Sections 214(a) and 310(d) of the Act, “[a]pplicants bear the burden of demonstrating that the proposed transaction is in the public interest,” taking into consideration the “broad aims of the Communications Act.” <sup>10/</sup> This examination “necessarily subsumes and extends beyond the traditional parameters of review under the antitrust laws.

In order to find that a merger is in the public interest, we must, for example, be convinced that it will enhance competition. A merger will be pro-competitive if the harms to competition – *i.e.*, enhancing market power, slowing the decline of market power, or impairing this Commission's ability properly to establish and enforce those rules necessary to establish and maintain the competition that will be a prerequisite to deregulation – are outweighed by benefits that enhance competition. If applicants cannot carry this burden, the applications must be denied. <sup>11/</sup>

AT&T cogently commented on the need for the Commission to apply this standard strictly in the context of the Bell Atlantic-GTE merger: “It is virtually always more profitable for rivals to merge than compete. Where such profitability comes at the expense of competition, however, consumers are harmed.” <sup>12/</sup> AT&T discussed how that transaction “would cause substantial harm to local competition within their in-region markets by eliminating the other Applicant as a

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<sup>10/</sup> *Bell Atlantic-NYNEX Merger Order* at ¶ 30.

<sup>11/</sup> *Id.* (emphasis added).

<sup>12/</sup> *In the Matter of GTE Corp., Transferor, and Bell Atlantic Corp., Transferee, For Consent to Transfer of Control*, CC Docket No. 98-184, *Affidavit of John W. Mayo and David L. Kaserman on Behalf of AT&T Corp.*, ¶ 60 (emphasis added).

potential competitor.” 13/ AT&T expressed these same concerns in the context of SBC’s acquisition of Ameritech. 14/

Ultimately the Commission approved the Bell Atlantic-GTE and SBC-Ameritech mergers, but not without extended consideration of the potential competition issue, and merger conditions requiring Bell Atlantic and SBC to compete outside their respective service territories. 15/ As the Commission knows, those conditions largely failed.

Now AT&T comes before the Commission proposing a merger in which it would give up actual competition in its role as SBC’s primary rival in the SBC service territory, and not just the potential for competition that so concerned AT&T in the prior mergers. As Qwest will discuss below, the harm to competition could not be more clear – as AT&T presumably would agree if it were not a party to the proposed merger itself.

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13/ *In the Matter of GTE Corp., Transferor, and Bell Atlantic Corp., Transferee, For Consent to Transfer of Control*, CC Docket No. 98-184, *Opposition of AT&T Corp. to Applicant’s Supplemental Filing and Renewal of AT&T’s Petition to Deny*, March 1, 2000, at 6.

14/ AT&T warned that: “By combining and shielding their monopoly markets from the most powerful, imminent source of competition – each other – Applicants can continue to foreclose the development of local competition by others and further entrench their monopoly power.” *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 215 Authorizations from Ameritech Corp., Transferor, to SBC Communications Inc., Transferee*, CC Docket No. 98-141, *Petition of AT&T Corp. to Deny Applications*, filed October 15, 1998, at i-ii; see also *id.* at 6-9.

15/ *In the Matter of GTE Corp., Transferor, and Bell Atlantic Corp., Transferee, For Consent to Transfer Control*, CC Docket No. 98-184, *Memorandum Opinion and Order*, 15 FCC Rcd 14032, 14182-84 (¶¶ 319-323) (2000) (“GTE-Bell Atlantic Merger Order”); *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 215 Authorizations from Ameritech Corp., Transferor, to SBC Communications Inc., Transferee*, CC Docket No. 98-141, *Memorandum Opinion and Order*, 14 FCC Rcd 14712, 14877-78 (¶¶ 398-399) (1999) (“SBC-Ameritech Merger Order”).

**III. THE MERGER WOULD CREATE NEARLY UNPRECEDENTED CONCENTRATION IN THE SBC SERVICE TERRITORY BY ALLOWING SBC TO ACQUIRE ITS PRIMARY COMPETITOR**

The most obvious competitive issue created by the proposed merger is the horizontal overlap between AT&T facilities and services in the 13-state SBC local exchange territory. <sup>16/</sup> Unfortunately, however, the two parties have prevented the Commission and third parties from fully evaluating the scope of that overlap. They have chosen not to identify exactly where AT&T operates facilities in the SBC region, how AT&T's products overlap with those of SBC, or how many customers they each have in particular markets by service.

This lapse might be justifiable if the parties were proposing to eliminate all in-region overlap by divestiture. However, from the outset they have made clear that they have no such plans. Thus, for example, SBC's Chairman and Chief Executive Officer testified in Congressional hearings on March 2: "We're taking the position, and I think rightfully so, that since we don't overlap in any businesses we shouldn't have to divest anything, because we're not in the same businesses." <sup>17/</sup> Consistent with that position, the Application here makes no mention whatsoever of divestiture.

The Commission has begun to test the SBC and AT&T claim through the Wireline Bureau's April 18 Information Request. Presumably when the parties respond they will drop

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<sup>16/</sup> Bernheim Declaration at ¶¶ 11, 38-83.

<sup>17/</sup> Testimony of Ed Whitacre, Hearings before House Energy and Commerce Committee at 84 (March 2, 2005). Similarly, on the day SBC announced its merger with AT&T, Mr. Whitacre directly responded to a question regarding whether the combined company would have to divest any assets: "There are no regulatory conditions in the plan at this point in time, and we don't expect any." Ed Whitacre, remarks during conference call titled *SBC-Analyst Conference Call to Discuss SBC's Planned Acquisition of AT&T* (January 31, 2005) (transcript available through Fair Disclosure Wire).

their position that they “don’t overlap in any businesses,” and begin to provide geographically disaggregated detail on AT&T’s activity in the SBC service territory.

Meanwhile, the basic parameters of the transaction are clear, and they of course raise serious competitive questions on their face. SBC is the nation’s second largest telephone company behind Verizon, with nearly \$41 billion in revenue in 2004 and more than 160,000 employees. 18/ The 13-state SBC territory includes some of the nation’s most heavily populated areas and major business centers, including California, Texas, Missouri, Illinois, Wisconsin, Indiana, Ohio, and Connecticut. SBC brags on its web site that “[w]ith more than 52 million access lines, SBC companies provide service for nearly 30 percent of the telephone lines in the country, touching more than 37 million customer locations.” 19/

AT&T, the SBC target, is the nation’s largest competitive carrier, with over \$30.5 billion in revenue in 2004, and employing over 47,000 people. AT&T states that as of 2004 it had approximately 35 million residential customers, including 30 million “standalone” long-distance customers; 4.3 million “bundled” local/long-distance customers and 1.4 million customers of its DSL and Worldnet Internet services.” 20/ In addition, AT&T began offering its VoIP service, AT&T CallVantageSM, in areas of California, Massachusetts, New York, New Jersey, and Texas in early 2004, with plans to expand to 100 markets by the end of 2004. 21/ Today, it is available to consumers in more than 170 markets coast-to-coast representing 62% of the nation’s households. 22/ AT&T bundled local and long distance service is available in 46 states,

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18/ Bernheim Declaration at ¶ 17.

19/ <http://www.sbc.com/gen/investor-relations?pid=5708>.

20/ The AT&T Advantage (2004); <http://www.att.com/ir/ap/factsheet.html>.

21/ *Id.* AT&T has the express intention of migrating its existing retail customers to VoIP.

22/ <http://www.att.com/news/2004/10/14-13281>

covering more than 73 million households, while bundled residential local, long-distance and high speed DSL service is available in 25 states. 23/ It goes without saying that a substantial percentage of AT&T's customers are in the 13-state SBC local service territory.

SBC and AT&T attempt to sidestep this huge overlap with the disingenuous assertion that their merger is merely the combination of "complements" rather than the elimination of competitors, and that this combination will enhance rather than reduce competition. 24/ SBC characterizes its business as serving residential and small business customers, while describing AT&T's business as serving national and global enterprise accounts. 25/

The Commission knows better. Both of these companies offer full telecommunications product sets in competition with one another. SBC proudly asserts elsewhere that: "Throughout its 13-state territory, SBC offers a wide range of services, from local and long distance telephone service to high-capacity data services for businesses. SBC Wireline also is the nation's leading provider of DSL Internet and is now the second-largest long distance provider in the country." 26/ These services directly overlap with those of AT&T, which is more forthcoming on its web site:

AT&T is among the premier voice, video and data communications companies in the world, serving businesses, consumers and government. The company runs the largest, most sophisticated communications network in the U.S., backed by the research and development capabilities of AT&T Labs. A leading supplier of data, Internet and managed services for the public and private sectors, AT&T offers outsourcing and consulting to large businesses and government. [AT&T] is a market leader in local,

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23/ *Id.*

24/ Application, *Description of the Transaction, Public Interest Showing, and Related Demonstrations*, pp. iii-iv, 6.

25/ *Id.* at 6.

26/ <http://www.sbc.com/gen/investor-relations?pid=5676>.

long distance and Internet services, as well as transaction-based services like prepaid cards, collect calling and directory assistance. 27/

In short, while the merger parties have held back data necessary to evaluate their overlap on a market-by-market basis, it is clear that AT&T is SBC's largest retail wireline competitor, across its entire territory and across all services. Data on retail consumer and business market shares for SBC and AT&T in SBC's region demonstrate the very substantial overlap between the merging companies for both consumer and business customers. Moreover, in most instances AT&T is SBC's largest competitor:

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The parties' calculated failure to provide any material detail regarding the scope of that overlap in the SBC states is a prima facie failure to meet their burden of proof under Sections 214(a) and 310(d).

Furthermore, SBC and AT&T completely ignore overlapping competition in the wholesale market. SBC obviously is the dominant provider of wholesale services to carriers in most of the relevant geographic markets in its region. 28/ AT&T has deployed competitive local

27/ <http://www.att.com/ir/ap/factsheet.html>.

28/ Bernheim Declaration at ¶ 40.

data and voice facilities nationwide, with 157 switches and over 8,200 SONET rings, and direct on-net connections to more than 6,400 customer buildings nationwide in 70 MSAs in 38 states. <sup>29/</sup> Of course, many of these wholesale facilities are in the SBC region.

Finally, the parties completely fail to address the significance of SBC's majority ownership position in Cingular Wireless, the nation's largest wireless company, serving 50 million customers across the country, with a particularly strong presence in the SBC region. This too is a material omission warranting rejection of the Application, especially given the parties' contention elsewhere that wireless services are a competitive substitute for the SBC and AT&T wireline services that would be consolidated by the merger. <sup>30/</sup>

Under Section 1.5 of the *Merger Guidelines*, mergers of competing firms with substantial combined market shares in highly concentrated markets are presumed to create or enhance market power or facilitate its exercise in violation of Section 7 of the Clayton Act. <sup>31/</sup> But the

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<sup>29/</sup> <http://www.att.com/ir/ap/factsheet.html>. See also Bernheim Declaration at ¶ 41.

<sup>30/</sup> Application, *Declaration of Dennis W. Carlton and Hal S. Sider*, pp. 11-15.

<sup>31/</sup> Bernheim Declaration at ¶ 45. That is why, for example, the Justice Department concluded that the Cingular/AT&T Wireless merger violated Section 7, absent remedies. As the Justice Department stated in its Competitive Impact Statement:

"Cingular's proposed acquisition of AT&T Wireless will substantially lessen competition in mobile wireless telecommunications services and mobile wireless broadband services in the relevant geographic areas." Competitive Impact Statement, *United States v. Cingular Wireless*, Civil Action No. 1:04CV01850 (RBW) (D.D.C. Oct. 29, 2004).

"The individual market shares of Cingular's and AT&T Wireless's mobile wireless telecommunications services businesses in the 10 relevant geographic markets as measured in terms of subscribers range from 9 to more than 71 percent, and their combined market shares range from 61 to nearly 90 percent. In each relevant geographic market, Cingular or AT&T Wireless has the largest market share, and, in all but one, the other is the second-largest mobile wireless telecommunications services provider." *Id.* at 10-11.

Commission and third parties cannot fully evaluate the scope of the SBC and AT&T overlap here until and unless the parties themselves begin that process with reasonable granularity. The questions posed by the Commission are a first step in the right direction. 32/

In the meantime, however, SBC and AT&T bear the burden of proof regarding competition issues raised by the extent of the overlap. Absent a more comprehensive showing in this area that permits practical evaluation – on a service-by-service and market-by-market basis – the Application is deficient on its face and should be rejected.

#### **IV. THE MERGER WOULD DAMAGE POTENTIAL COMPETITION TO SBC BY NEW TECHNOLOGIES AND CONVERGENCE**

While SBC and AT&T fail to provide detail on the concentration arising from their merger, they do anticipate in general terms some of the competitive issues that this overlap presents. Their response, however, is completely disconnected from any analysis of actual competitive conditions in actual SBC markets. 33/ In addition, the merger parties focus on retail services and largely ignore critical wholesale market issues. As a result, they steer away from an

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“Cingular and AT&T Wireless are likely closer substitutes for each other than the other mobile wireless telecommunications services providers in the relevant geographic markets.” *Id.* at 11.

“For these reasons, plaintiffs concluded that Cingular's proposed acquisition of AT&T Wireless will likely substantially lessen competition, in violation of Section 7 of the Clayton Act, in the provision of mobile wireless telecommunications services and mobile wireless broadband services in the relevant geographic markets.” *Id.* at 13.

32/ Bernheim Declaration at ¶ 34.

33/ *Id.* at ¶¶ 94-102.

entire category of damaging merger effects: the impact of the merger on emerging convergence and competition to the SBC local network. 34/

Qwest agrees that the telecommunications market is in a period of change, and that competition is increasing. But the question here is how this merger, and the interrelated Verizon-MCI combination, would impact these developments. 35/

Here too Qwest will be in a better position to address these matters once SBC and AT&T provide more information about actual conditions in the many markets in the SBC region. Nevertheless, some preliminary observations are possible.

**A. Wholesale Markets**

First, the merger would directly harm competition in the market for wholesale inputs required by all SBC competitors, including new competitors appearing as convergence matures. SBC is the primary source of unbundled network elements and collocation required by facilities-based CLECs in its region. 36/ It is the primary source of special access and transport services rivals need to reach customer premises. 37/ It is the dominant provider of switched access, especially terminations to its enormous wireline PSTN customer base.

To begin with, through this merger SBC would eliminate its most significant current wholesale competitor by consolidating the AT&T wholesale facilities and services in its region. 38/ AT&T is the nation's largest CLEC and has deployed the most alternative local

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34/ *Id.* at ¶¶ 96-98.

35/ *Id.* at ¶¶ 11, 29-31.

36/ *Id.* at ¶ 40.

37/ *Id.*

38/ *Id.* at ¶ 48.

facilities across the country, including in SBC's region. 39/ SBC's competitors rely on AT&T facilities to bypass SBC today. 40/

SBC also is eliminating its most likely potential wholesale competitor in geographic locations not yet served by alternative facilities. 41/ As noted above, AT&T has been expanding its local networks in recent years, significantly more so than other CLECs. This reflects the relatively greater incentives and ability AT&T has to bypass the LEC, arising from its larger customer base and associated demand and scale economies. But for this merger, AT&T would continue to have the incentives and scale economies to deploy more local facilities to reduce its dependence on SBC. AT&T also would have incentives to make those alternative facilities available to other SBC competitors.

This is not to minimize the practical constraints on wireline bypass in certain geographic markets. AT&T has repeatedly argued that even a company its size is not able to justify investment in high capacity loops and transport services in many locations, and hence it is dependent on SBC and other LECs to reach a high percentage of customer premises. 42/ But if AT&T is no longer on the scene to deploy new local facilities, for itself and for other SBC competitors, it is certain that competition to SBC will suffer. SBC/AT&T will control the largest

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39/ *Id.* at ¶¶ 41, 48.

40/ *See, e.g.,* Testimony of Jeffrey Citron, CEO of Vonage Holdings Corp., and Carl Grivner, CEO of XO Communications, Inc., Before the Senate Judiciary Committee (April 19, 2005), *available at* <http://judiciary.senate.gov>.

41/ Bernheim Declaration at ¶ 48.

42/ *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593, at 4-5 (filed Oct. 15, 2002).

share of the market, and the largest customers; their rivals will lack the scale necessary to invest in competing facilities. 43/

Moreover, Section 251(c) of the Act requires that ILECs (such as SBC) make available UNEs at prices established pursuant to Section 252(d)(1)(A) where competitors are “impaired” under the Section 251(d)(2) standard. The clear intent of the Act was to spur the growth of true “facilities-based” competition within local exchange markets. 44/ The existence and operation of AT&T as an independent and vital competitor within SBC’s local exchange markets goes a long way toward both providing and documenting the facilities-based competition that the Act is meant to support and sustain. It also reduces the “impairment” suffered by competitors in the absence of unbundled access to SBC’s facilities. 45/ In any event, UNEs are no substitute for the real facilities-based competition that would be lost through the proposed merger.

For all of these reasons, the Commission cannot approve this merger until it fully evaluates all overlap between SBC and AT&T wholesale local exchange services and facilities, as well as the likely consequences of elimination of AT&T as a continuing SBC overbuilder. 46/ This is not purely a local exchange matter. The Commission also must evaluate overlap of SBC

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43/ Bernheim Declaration at ¶¶ 45-48.

44/ See *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, *Third Report and Order and Fourth Further Notice of Proposed Rulemaking*, ¶ 14 (rel. November 5, 1999) (noting “preference for development of facilities-based competition”); *Verizon Communications, Inc. v. FCC*, 535 U.S. 467, 122 S. Ct. 1646, 1669 (2002) (finding a Congressional intent to stimulate facilities-based competition).

45/ By establishing a test for impairment based on the number of fiber-based collocation cages in a given wire center, the Commission expressly recognized that the absence of statutory impairment could be evaluated based on the number of independent competitors in a market. See *In the Matter of Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, *Order on Remand* at ¶ 66 (rel. Feb. 4, 2005).

46/ Bernheim Declaration at ¶¶ 40-43.

and AT&T wholesale interexchange facilities, particularly to identify any secondary or tertiary routes to smaller towns in the SBC region where those two companies may have the only available transport facilities. 47/

SBC's acquisition of AT&T – the next-best substitute for SBC – may give SBC the unilateral ability to raise prices in its region. Antitrust law recognizes that unilateral anticompetitive effect can occur when merging firms with differentiated products are close substitutes for one another. 48/ The likelihood of unilateral anticompetitive effects increases where consumers “regard the products of the merging firms as their first and second choices” and it is unlikely that remaining firms in the market will reposition their products to replace the competition lost between the merging firms. 49/ The *Merger Guidelines* presume that consumers “regard the products of the merging firms as their first and second choices” where (1) the firms’ market shares reflect their relative appeal to consumers; (2) the market is highly concentrated; and (3) the “merging firms have a combined market share of at least 35%.” 50/

Thus, for example, *FTC v. Swedish Match* involved the merger of the largest and third largest loose leaf chewing tobacco manufacturers. The FTC claimed that (1) many consumers considered the merging parties to be close substitutes, (2) the market was highly concentrated, and (3) the merging parties combined market share would exceed 60%. 51/ The court endorsed

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47/ *Id.* at ¶¶ 51-54.

48/ United States Dep’t of Justice & Federal Trade Comm’n, *Horizontal Merger Guidelines* (“*Merger Guidelines*”), § 2.2 (1992). See David T. Scheffman and Mary Coleman, *Quantitative Analyses of Potential Competitive Effects from A Merger*, June 9, 2003, available at [www.usdoj.gov/atr/public/workshops/docs/202661.htm](http://www.usdoj.gov/atr/public/workshops/docs/202661.htm). See also Dennis W. Carlton & Jeffrey M. Perloff, *Modern Industrial Organization* (2000).

49/ *Merger Guidelines*, § 2.21.

50/ *Id.* at § 2.211.

51/ *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 169 (D.D.C. 2000)

the FTC's view: "Swedish Match will raise prices as long as the profit gained by the higher prices of Swedish Match products in addition to the profits diverted to National's brands is greater than the profits lost through diversion to non-Swedish Match Brands." 52/

Here, the potential for unilateral anticompetitive effects is significant given that the market is highly concentrated, SBC and AT&T enjoy the highest market shares in SBC's region, SBC and AT&T have the most significant brands and customer recognition, the SBC-AT&T combined market share exceeds 35%, and other firms can not replace the competition being lost from an independent AT&T. 53/ In fact, in some areas, AT&T may be the only wholesale substitute for SBC. The *Merger Guidelines* presume market power from such high concentration. The full extent of the unilateral effects problems caused by the proposed SBC/AT&T merger only will become clear after SBC and AT&T supply sufficient data to allow a meaningful analysis. But there certainly is reason for serious concern. That concern would be further exacerbated if Verizon acquires MCI, which makes it less likely that MCI's assets will be used for vigorous competition in the SBC region.

#### **B. Retail Markets**

SBC and AT&T similarly fail to provide any disaggregated data regarding competition in the retail market in the SBC territory, even though they are the two largest service providers. 54/ The parties generally ignore the question of where and how their services overlap, and instead argue that this overlap is irrelevant given competition from other parties.

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52/ *Id.* at 169-70.

53/ Bernheim Declaration at ¶ 59.

54/ *Id.* at ¶¶ 57-58.

Qwest agrees that competition is growing in the retail telecommunications market. However, SBC and AT&T overstate the scope of that competition in SBC's region. They ignore the extent to which that competition depends on use of SBC wholesale facilities, and the ability of competitors to bypass SBC using AT&T facilities. They also ignore the relevance of SBC's own large position in the wireless market.

Because of these problems, the potential for unilateral anticompetitive effects also exists in the retail market. Even the limited data and information now available show that AT&T is the next-best substitute for SBC based on combined market shares that range from [\*\*\*\*\*] (*see* p. 15, *supra*), a highly concentrated market, and the likely inability of other firms to replace the competition that will be lost following this merger. These matters must be evaluated further once SBC and AT&T supplement the record with appropriate data. Qwest provides some preliminary comments here.

#### 1. Business Services

SBC and AT&T argue that their merger will not have anticompetitive consequences for the business market, making generalized statements regarding both alternative wireline and intermodal competition. <sup>55/</sup> When these claims are more closely examined, however, a different picture appears in the SBC region. <sup>56/</sup>

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<sup>55/</sup> *Id.* at ¶¶ 63-65.

<sup>56/</sup> *Id.* at ¶¶ 93-101.

(a) CLECs

First, under the Department of Justice Merger Guidelines, whenever a transaction makes a very large competitor even larger, significant competitive concerns are raised even if the change in concentration would be relatively small. <sup>57/</sup> In this case, SBC is proposing to acquire its largest competitor region-wide. When the Commission evaluates AT&T's overlapping presence in particular geographic and product markets, as it must, the Commission may find that in certain locations AT&T is SBC's second largest competitor. But even then, because SBC's share is so high, <sup>58/</sup> and the market already is highly concentrated, the post-merger Herfindahl-Hirschman Index is likely to raise presumptions of market power even if AT&T's share is relatively small.

Second, the Commission will need to determine the extent to which MCI is the second largest competitor to SBC today. <sup>59/</sup> As discussed in Section VI, Verizon and SBC have sharply limited the scope of their competition in each other's regions. They will have even greater incentives to pursue policies of mutual forbearance if both of their proposed mergers are approved. <sup>60/</sup> Hence, the Commission must consider how much any competition from MCI in the SBC region today must be discounted in considering the post-merger market. <sup>61/</sup>

Third, to the extent that the merger parties are relying on smaller CLECs, it is even more important to identify the particular geographic markets where those CLECs operate, and the scope of the services they provide. It is not enough for the parties simply to list CLEC names

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<sup>57/</sup> *Id.* at ¶ 49, citing *Merger Guidelines*, § 1.5.

<sup>58/</sup> *Id.* at ¶ 59.

<sup>59/</sup> *Id.* at ¶ 61.

<sup>60/</sup> *Id.*

<sup>61/</sup> *Id.* at ¶ 61-62.

without reference to their competitive significance. 62/ The financial strength of these CLECs, and their ability to expand to serve new markets, also would be relevant. Qwest will defer commenting on this market definition issue further pending review of the supplemental data to be filed by SBC and AT&T.

Fourth, the proposed merger of SBC and AT&T would have direct consequences on the dependence of other CLECs on SBC wholesale inputs. They would lose AT&T as an independent source of such facilities and services, both with respect to existing AT&T offerings, and insofar as AT&T no longer would constrain SBC pricing through its overhang as the company best positioned to expand the supply of alternatives to SBC in that company's region. In short, by acquiring AT&T, SBC directly reduces the competition it will face from other CLECs.

**(b) Wireless**

SBC and AT&T also assert that their post-merger market power will be constrained by developing competition from wireless companies. 63/ Here again, Qwest agrees that – as a general matter – wireless is an increasingly important intermodal competitor to wireline services, but that does not answer the relevant question for analysis of this merger. 64/ The Commission must evaluate SBC's ownership of Cingular Wireless, and the extent to which the merger further

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62/ See Application, *Description of the Transaction, Public Interest Showing, and Related Demonstrations*, pp. 78-80.

63/ Application, *Declaration of Dennis W. Carlton and Hal S. Sider*, pp. 14-15 (making no distinction between wireless competition in residential and business markets).

64/ Bernheim Declaration at ¶ 79.

increases SBC's particular disincentives to develop wireline products that compete against its own wireline services in its region. <sup>65/</sup>

The Commission addressed this subject just six months ago when it approved Cingular's acquisition of AT&T Wireless. The Commission noted that because SBC (and BellSouth, Cingular's other owner) "derive such a significant portion of their revenues from their in-region wireline operations, these companies have an incentive to protect their wireline customer base from intermodal and intramodal competition." <sup>66/</sup> The Commission found that "Cingular has developed and marketed many of its wireless products and services to complement – and specifically not to replace – residential wireline service." <sup>67/</sup> Cingular and SBC coordinate directly for this purpose "and thus, address the growth of wireline substitution."

Significantly, the Commission also found that Cingular's acquisition of AT&T Wireless would be "likely" to reduce intermodal wireless-wireline competition. Cingular would acquire AT&T Wireless subscribers in the SBC and BellSouth regions. The result would be increased disincentive to compete and innovate. The Commission explained:

This would further reduce Cingular's incentives to make available wireless substitute offerings, as Cingular wireless customers would end up reducing the number of SBC and BellSouth wireline access lines by cutting the cord. As a result, it appears that Cingular is unlikely to initiate its own wireless substitute offering post-acquisition in the SBC and BellSouth regions. Thus, one potential harm arising from Cingular's acquisition of AT&T Wireless is an increased disincentive for the merged entity to offer new innovative plans that would further intermodal competition in these areas. <sup>68/</sup>

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<sup>65/</sup> *Id.* at ¶ 81.

<sup>66/</sup> *Memorandum Opinion and Order, Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation for Consent to Transfer of Control*, WT Docket No. 04-70, FCC 04-255, at ¶ 237 (Oct. 26, 2004).

<sup>67/</sup> *Id.* at ¶ 244.

<sup>68/</sup> *Id.* (emphasis added).

Furthermore, the Commission found that the merger would harm potential intermodal competition given the “likelihood that Cingular would not pursue AT&T Wireless’s extensive plans for wireline replacement offerings.” The Commission observed that this problem would not exist if AT&T Wireless remained independent, or even if it was acquired by another wireless carrier independent of a major LEC. 69/

The Commission only allowed the Cingular/AT&T Wireless merger because it concluded that the risk of harm would be relatively low because “most wireline consumers do not now consider wireless service to be a close substitute for their primary line obtained from a wireline carrier.” 70/ Qwest does not agree with this conclusion. We are experiencing substantial substitution of wireless service in Qwest’s region.

But this fact only underscores why the Commission should reject SBC’s glib assertions that its acquisition of AT&T is procompetitive. By acquiring its primary wireline competitor, SBC is further reducing the risk that wireless intermodal competition will erode its core wireline services in its region, now and in the future. SBC is substantially increasing its wireline customer base by capturing its main rival, which further reduces Cingular’s incentive to compete with SBC wireline services. SBC also is eliminating AT&T as a potential partner with an independent wireless company, and the risk that such a joint venture or other combination could attack the SBC wireline base – and Verizon proposes to do the same thing with MCI.

Here Qwest is focusing on merger effects in the retail business sector. Significantly, in the Cingular-AT&T Wireless merger the Commission primarily considered intermodal wireless competition in the context of mass market services. However, the anticompetitive impacts of the

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69/ *Id.* at ¶ 246.

70/ *Id.* at ¶ 247.

proposed SBC-AT&T merger could be even more serious in the business market. To date broadband wireless has not been deployed in a manner that permits business customers to replace their wireline facilities. As a result, SBC cannot point to significant intermodal competition from wireless in the business market for anything above basic single line voice.

But more important, this merger would affirmatively harm prospects for future business wireless services that might compete with SBC. For such intermodal competition to develop, providers must be able to originate and terminate service to business locations on a broadband basis that can compete with SBC's DSL and high capacity access. Today Cingular has limited incentives to deploy such innovative wireless facilities, especially on a rapid timetable or at an efficient price, because the result would be to threaten SBC's wireline business base. Cingular has even less incentive to market wireless access on a wholesale basis to other providers, or to partner with them in developing innovative services.

This merger would make the problem even worse. First, SBC's acquisition of AT&T would further increase SBC's wireline business base, and so further reduce Cingular's incentives to develop broadband wireless substitutes for the business market. Second, SBC would eliminate AT&T as a potential partner for independent wireless firms who could better accelerate their broadband wireless plans with AT&T support, and so bypass the SBC local network. In short, this proposed merger would seriously harm prospects for real wireless competition in the business market in the SBC region.

The merger would also have anticompetitive effects in the long distance market inside and outside the SBC region. While wireless substitution for local services varies, no one can dispute that substitution occurs in the long distance market. Cingular competes directly with AT&T in long distance. It follows that if SBC acquires AT&T, Cingular could have reduced

incentives to offer lower prices or innovative all-distance services to the business market, and SBC could operate the former AT&T's out-of-region wireline services to compete less vigorously with Cingular. The Commission will need to investigate the potential loss of competition from these merger effects as this proceeding goes forward.

These matters also intersect with the risks of mutual forbearance between SBC and Verizon discussed in the next section of this Petition. It is highly significant that Verizon controls the nation's other leading wireless company. The proposed Verizon-MCI merger raises all of these same risks to wireline-wireless competition in the Verizon local service territories, now and in the future. <sup>71/</sup> If both mergers are approved, the parties will have strong incentives, not only to discourage wireline-wireless competition within their respective regions, but also between their regions. SBC and Cingular would "manage" wireline and wireless services in the Verizon region to ensure that Cingular does not threaten Verizon's wireline base, especially through new broadband wireless to business customers. Verizon Wireless would generally forbear in the same way in the SBC region.

In short, the SBC-AT&T merger is a direct threat to the kind of wireless intermodal competition that is the Commission's goal. This alone is a reason to reject their Application.

**(c) Cable**

SBC and AT&T also make generalized arguments regarding the role of cable television systems as competitors in the business market. Qwest agrees that in certain geographic markets cable provides strong competition in the business market. However, in other markets cable

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<sup>71/</sup> Bernheim Declaration at ¶¶ 11-12, 95-96.

providers have not yet constructed facilities into business districts or begun to offer business services. 72/

In the context of a merger review, the DOJ and/or the Commission consider likely competitive entry within two years from the time of the merger. 73/ To date, however, SBC and AT&T have not provided any record support as to exactly which business markets in the SBC region are now served by cable operators, or the actual scope of cable business services in those markets, or how that is likely to change in the next two years. Nor have they discussed the extent to which cable operators fully bypass SBC facilities when they serve the business market, or how much they rely on wholesale SBC facilities and services, or how that will change over the applicable two year time horizon.

The latter point is significant. Cable operators may be able to expand into the business market more rapidly if they do so using third party facilities from AT&T and other non-SBC providers. In particular, for example, the cable systems formerly owned by AT&T may provide business telecommunications services using local switches and transport supplied by AT&T on a wholesale basis. The merger would adversely impact such cable systems if their independent source of necessary inputs was now consolidated with SBC. As a result, SBC's proposed merger with AT&T could reduce the timeliness, likelihood, and sufficiency of cable entry in particular markets.

But of course SBC and AT&T have yet to provide the Commission or interested parties with any specific market data from the SBC region to support their arguments that cable companies provide sufficient competition to ameliorate the harm otherwise caused by this

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72/ *Id.* at ¶ 65.

73/ *Merger Guidelines*, § 3.2.

merger. Nor have they identified where AT&T is providing wholesale inputs to cable operators. SBC's generalized arguments are not sufficient in the context of a merger review.

**(d) VoIP**

Finally SBC and AT&T make general statements suggesting that VoIP provides an effective check on the increased market power SBC would enjoy as a result of this merger. Qwest agrees that VoIP is an important new development that will only grow in significance. Qwest itself has been an early and strongly committed deployer of VoIP services.

But here too, the issue is how this particular merger would impact VoIP. <sup>74/</sup> First, and most obviously, SBC is eliminating AT&T as a VoIP competitor. This development is particularly significant because AT&T has announced its own major commitment to VoIP, including plans to migrate its customers to VoIP. <sup>75/</sup> The Commission will need information that allows it to evaluate the significance of SBC eliminating its largest potential VoIP-based competitor. <sup>76/</sup> SBC and AT&T have not supplied the necessary information to date.

Second, VoIP itself is a service that depends on the customer having a broadband connection. Today SBC provides most broadband connections to businesses in its own region. <sup>77/</sup> CLECs have limited local loop facilities, in limited geographic markets. Wireless broadband is not widespread – especially wireless that is independent of SBC and Cingular. Cable serves businesses only in particular geographic locations. And as discussed above,

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<sup>74/</sup> Bernheim Declaration at ¶ 68.

<sup>75/</sup> <http://www.att.com/news/2004/03/24-12974>.

<sup>76/</sup> Bernheim Declaration at ¶ 68.

<sup>77/</sup> *Id.* at ¶ 83

approval of the SBC-AT&T merger would impair current and potential competition in each of these sectors, further entrenching SBC as the dominant source of business broadband.

Today SBC further blocks competition from VoIP by refusing to provide “naked DSL.” This is telling evidence of SBC’s willingness to compete post-merger, when its incentives to restrict competition in its market would be even higher. However, the larger story of this merger is the extent to which SBC would reduce the threat of facilities-based wireline and intermodal competition in its region across the board. SBC proposes to acquire its principal rival, the one most likely either to deploy bypass technologies or partner with those who will. SBC’s acquisition of AT&T would increase its own disincentives to deploy new technologies that could result in bypass of its local network. And it would do so in tandem with Verizon’s proposed acquisition of MCI, a transaction that would have parallel anticompetitive effects in the Verizon region.

## **2. Residential Services**

The issue here is how the proposed merger would impact residential competition, especially in the SBC service territory. <sup>78/</sup> Once again it will be important for the Commission to examine potential merger effects on a product-by-product basis in separate geographic markets. <sup>79/</sup> Qwest will be brief for now, highlighting key similarities and differences between the residential markets, and the business market already discussed above. Again, SBC and AT&T have failed to provide the data necessary for the Commission and third parties to analyze these issues.

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<sup>78/</sup> *Id.* at ¶¶ 74-83.

<sup>79/</sup> *Id.* at ¶ 78.

(a) CLECs

To state the obvious, SBC is acquiring its primary wireline competitor in the residential market. The parties attempt to dismiss this fact with an argument that AT&T already had decided to withdraw from that market before deciding to put itself up for sale to SBC. 80/ This is a question of fact that must be investigated on a product by product basis. 81/ The analysis must include review of AT&T's announced plans to migrate customers to VoIP, as well as the impact on any partnering with third party marketers of its various services. The Commission also must evaluate the competitive significance of AT&T's continuing embedded base of customers. 82/ The Commission also should consider whether AT&T's customers would be better served if SBC is forced to compete to win their business.

Second, SBC and AT&T point to various other wireline CLECs that they assert will prevent the merger from harming residential subscribers, without specifying where those CLECs compete, as they must for a proper *Merger Guidelines* analysis. 83/ The answer here is the same as in the business service discussion above. The Commission should reject generalized lists of CLECs, and determine exactly which CLECs are competing in which residential markets. In doing so, the Commission should discount the relevance of MCI as a competitive force given that MCI also claims to be abandoning the residential market, and the particular risk that SBC and Verizon will not actively compete in each other's region post-merger.

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80/ Application, *Description of the Transaction, Public Interest Showing, and Related Demonstrations*, pp. 48-56.

81/ Bernheim Declaration at ¶ 77.

82/ *Id.* at ¶ 76.

83/ Application, *Description of the Transaction, Public Interest Showing, and Related Demonstrations*, p. 62.

Third, the Commission must take into consideration the dependence of CLECs on SBC, which is made worse by the merger. The Applicants suggest, for example, that once the Commission modified its rules regarding UNE-P, that was the death knell for AT&T's ability to compete in the residential market. They do not explain why, in that case, other CLECs will be able to compete effectively with SBC and maintain and expand their residential business. Significantly, Qwest itself has actively worked with CLECs, including AT&T, to offer its QPP wholesale services so that CLECs can compete its region. SBC does no such thing.

Fourth, the Commission must determine the extent to which CLECs in various geographic markets have been making use of AT&T wholesale facilities to provide their retail services. Because the merger eliminates such alternative access facilities used in the residential market, it establishes further barriers to firms that compete with the combined SBC-AT&T market position. As discussed above, AT&T is best suited to expand bypass opportunities by deploying switches and transport that could be used for residential service. If AT&T will not do so, it is problematic who will. For all of these reasons, the Commission will need to carefully evaluate the ability of CLECs to provide a check on the market power of SBC in the SBC region once it has eliminated AT&T as a competitor.

**(b) Wireless**

Qwest already has discussed the adverse impact of the merger on potential intermodal competition in the business market given SBC's ownership of Cingular, particularly with respect to wireless broadband services that could bypass the SBC wireline network.

Qwest agrees that residential wireless services are a substitute for consumer wireline voice and data services in our region where we do not operate material wireless facilities, and

provide wireless service primarily on a resale basis. Consumers have demonstrated that they are increasingly willing to replace our wireline service with the wireless services of our competitors. Our competitors have every incentive to, and do, design and market their services to encourage wireline replacement.

However, as discussed above, six months ago the Commission found that different market conditions existed in the SBC and BellSouth regions given their ownership of Cingular. 84/ The Commission found that Cingular designed its wireless services to complement rather than to replace wireline. And the Commission found that Cingular's acquisition of AT&T Wireless would enhance such incentives and eliminate AT&T Wireless as a potential developer of wireline substitutes. 85/ The same conditions apply here: SBC would increase its wireline customer base and further reduce its incentives to permit Cingular to develop wireline substitutes in its region. SBC would eliminate AT&T as a potential partner with other firms who might use the AT&T assets to support wireless substitutes. 86/

In particular, SBC would have less incentive to deploy broadband wireless services to consumers. We already have discussed this matter in the business service context, where it is particularly significant given the absence of non-SBC loops to the vast majority of business locations. But broadband wireless also is a factor in the residential market, where consumers would be losing AT&T as a potential supporter of such facilities to bypass SBC.

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84/ Bernheim Declaration at ¶ 81.

85/ See discussion, *supra*, at pp. 24-28, regarding business wireless.

86/ Bernheim Declaration at ¶ 81.

**(c) Cable**

Cable operators increasingly provide competition in the residential telecommunications market, and the Commission will need to evaluate the scope of that competition in the SBC region on a market by market basis – which it cannot do today because the applicants have not supplied the necessary data. <sup>87/</sup> In doing so, one important issue will be the extent to which particular cable systems rely on wholesale facilities and services provided by AT&T (arising from its previous ownership of those systems or otherwise). Clearly the merger would threaten cable competition that makes use of those assets. More generally, the Commission will need to evaluate how the elimination of AT&T may impair the ability of cable operators to expand their services in competition with SBC in its service territories.

**(d) VoIP**

Similarly, the Commission should evaluate the ability of VoIP to provide a competitive check on a post-merger SBC-AT&T. <sup>88/</sup> As in the business market, SBC is eliminating its largest potential rival in the VoIP market. Even when AT&T was downplaying its basic residential service offerings, it has spoken of replacing that service with CallVantage. <sup>89/</sup>

Furthermore, the Commission should address the dependence of VoIP providers on their customers having broadband access. <sup>90/</sup> In particular, it is noteworthy that to date SBC has

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<sup>87/</sup> *Id.* at ¶ 78.

<sup>88/</sup> *Id.* at ¶ 83.

<sup>89/</sup> <http://www.att.com/news/2004/03/24-12974>.

<sup>90/</sup> Some cable operators appear to be moving to VoIP as a technical transmission (or at least origination) protocol in lieu of circuit-switched origination. In that sense the Commission should take care that cable competition is not double-counted (as both CLEC and VoIP service).

refused to market naked DSL, blocking that potential tool for VoIP providers to achieve customer access. 91/

Finally, all VoIP providers depend on SBC for ubiquitous termination of calls to the tens of millions of SBC customers served by the PSTN. Until the Commission resolves the terms under which SBC provides that termination service, it is unclear how it may favor AT&T and disfavor other VoIP providers. 92/

## V. THE MERGER ELIMINATES A KEY “MAVERICK” IN INNOVATION

SBC’s proposed merger with AT&T poses additional competition concerns because independent stand-alone providers, including AT&T and MCI, have behaved as “mavericks” in introducing innovations in telecommunications that have benefited consumers, while SBC has resisted those innovations. As a result, the proposed SBC/AT&T merger is likely to stifle important innovation that has benefited customers.

It is a well established principle of antitrust law that the elimination of a “maverick” firm through merger or acquisition is likely to produce anticompetitive effects because of the loss of that maverick behavior. For example, Section 2.12 of the *Merger Guidelines* states:

In some circumstances, coordinated interaction can be effectively prevented or limited by maverick firms – firms that have a greater economic incentive to deviate from the terms of coordination than do most of their rivals (e.g., firms that are unusually disruptive and competitive influences in the market). Consequently, acquisition of a maverick firm is one way in which a merger may make coordinated interaction more likely, more successful, or more complete.

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91/ Bernheim Declaration at ¶ 83.

92/ See *In the Matter of IP-Enabled Services*, WC Docket No. 04-36, *Notice of Proposed Rulemaking*, 19 FCC Rcd 4863 (2004).

As one important antitrust commentator has explained, an industry maverick is a firm that is a disruptive competitive influence or that constrains more effective coordination by rivals, so removing a maverick through merger or acquisition is likely to result in higher prices. <sup>93/</sup> If the maverick is disruptive through innovation, then eliminating the maverick will likely reduce innovation.

AT&T has played an important role in innovations in the industry, while SBC has often balked at introducing innovations that might undermine its incumbent ILEC businesses. As a result of the proposed merger, AT&T will be lost as an independent innovator.

For example, AT&T has added residential DSL service to its bundled services in California (in SBC's service area). At the time bundled DSL was introduced, AT&T stated, "[w]e believe there's pent up demand from consumers frustrated by the lack of choice in bundled communications . . . from a company they can trust." <sup>94/</sup> Of course, the "lack of choice" that AT&T referred to was SBC's failure to offer such products. AT&T rolled out its VoIP program (CallVantage) nationwide in 2004, and has offered many VoIP innovations, including "voicemail with eFeatures," "Locate Me," conference calling, do-it-yourself home wiring (but with a technician available to visit the home), call filtering for unwanted calls, "record and send" that allows a message to be delivered to 20 separate phone numbers, and a "VoIP Innovation and Interoperability Program" designed to stimulate and foster development and adoption of new applications and capabilities. <sup>95/</sup> AT&T also claims to have pioneered network outsourcing. <sup>96/</sup>

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<sup>93/</sup> J. Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*, 77 N.Y.U.L. Rev. 135 (2002).

<sup>94/</sup> <http://www.att.com/news/2004/05/11-13061>.

<sup>95/</sup> *Talk is Cheaper*, PC Magazine at 107-117 (Feb. 8, 2005).

<sup>96/</sup> <http://www.ap.att.com/products/outsource.jsp>.

In contrast, SBC delayed DSL roll-out, probably because of possible adverse effects on its profitable T1 business. SBC also has refused to provide a “naked” DSL offering, apparently fearing that it would negatively affect its wireline operations. SBC has slow-rolled the introduction of VoIP service, probably because of the adverse impact it could have on SBC’s wireline operations.

If SBC acquires AT&T, this source of innovation that has benefited consumers will instead be in the hands of a firm that has resisted innovations that might undermine its ILEC businesses. In addition, AT&T is a key provider of wholesale services to other innovators, such as Vonage and XO, which have raised concerns about their ability to continue to secure those services if AT&T is owned by SBC. <sup>97/</sup> SBC and AT&T claim that their merger will increase innovation. But they offer no evidence for that claim, and there is substantial reason to fear that it will actually retard innovation. Verizon’s acquisition of MCI would be likely to have the same adverse consequences.

**VI. THE MERGER WOULD INCREASE INCENTIVES FOR MUTUAL FORBEARANCE BY SBC AND VERIZON, ESPECIALLY GIVEN THE PENDING VERIZON-MCI MERGER**

The Commission also will need to address the extent to which the SBC-AT&T and Verizon-MCI mergers increase the already existing incentives for those firms to refrain from most competition in each other’s markets. <sup>98/</sup> These deals present a real risk that the combined companies will engage in what economists refer to as “mutual forbearance,” tacitly colluding to

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<sup>97/</sup> See, e.g., Testimony of Jeffrey Citron, CEO of Vonage Holdings Corp., and Carl Grivner, CEO of XO Communications, Inc., Before the Senate Judiciary Committee (April 19, 2005), available at <http://judiciary.senate.gov>.

<sup>98/</sup> Bernheim Declaration at ¶ 31-32.

avoid direct competition. <sup>99/</sup> This risk is heightened by the fact that SBC and Verizon have a history of avoiding competition with each other, <sup>100/</sup> and as a result of the proposed transactions actually have increased incentives to continue this détente. <sup>101/</sup> In contrast, Qwest is the only RBOC that has competed aggressively out of region, and it would have every incentive to do so even more aggressively if it acquires MCI's substantial out of region assets.

AT&T itself discussed this problem in the context of the Bell Atlantic-GTE transaction:

For example, while post-merger SBC would be well poised to attack Bell Atlantic's most profitable market through its SNET territories, Bell Atlantic would likewise be well positioned to attack SBC in Los Angeles from GTE's Orange County territory. So while SBC may have incentives to enter the New York City metropolitan area, it knows that doing so would put its most lucrative market at risk to a significant competitor. Such "mutually assured destruction" scenarios greatly facilitate maintenance of the status quo in which both Bell Atlantic and SBC benefit by maintaining their monopolies. <sup>102/</sup>

Importantly, at the time AT&T was focused on the loss of potential SBC-Bell Atlantic competition, and the likelihood that it would lead to mutual forbearance. These two mergers are far more dangerous because SBC and Verizon are proposing to consolidate their two largest existing rivals, which enhances the risk of nationwide mutual forbearance by two regional monopolies.

The Commission therefore should work from the starting premise that these mergers will reduce competition through mutual forbearance – or “mutually assured destruction” to use AT&T's words. SBC and Verizon may continue to compete for the very largest enterprise

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<sup>99/</sup> *Id.*

<sup>100/</sup> *Id.* at ¶ 32.

<sup>101/</sup> *Id.* at ¶ 31.

<sup>102/</sup> *In the Matter of GTE Corp. Transferor, and Bell Atlantic Corp. Transferee, For Consent to Transfer of Control*, CC Docket No. 98-184, Petition of AT&T Corp. to Deny Application, at 34-35 (emphasis added).

accounts, at least those that do not have disproportionate numbers of end user locations in one region or the other. But even then, the competition may be less vigorous. Otherwise the proposed mergers increase the incentive and ability of SBC and Verizon to use their local market power to raise entry barriers to protect their respective (now even larger) in-region business bases, while simultaneously refusing to poach on one another's territory.

This anticompetitive danger is evidenced both by the past behavior of SBC and Verizon, and the new incentives created by the mergers. To begin with, the Commission is familiar with the fact that SBC and Verizon have largely avoided competition, even when ordered to do so, and despite the fact that these largest RBOCs are ideally suited to compete outside of their traditional regions. They more than anyone have the necessary financial resources, technical expertise, and market presence. Recognizing this, the Commission has repeatedly sought to encourage the RBOCs to compete out-of-region. Qwest, however, is the only RBOC that actually has made any significant effort to attack the markets of other ILECs. <sup>103/</sup> Yet Qwest is the RBOC exception and not the rule. If Qwest acquires MCI and its substantial nationwide assets and customers, its incentives to compete nationally are further enhanced.

Indeed, SBC and Verizon have failed to compete with one another even when ordered to do so. <sup>104/</sup> When the Commission approved SBC's acquisition of Ameritech in October 1999, one of the conditions was that SBC provide local service in thirty out-of-region markets, including Boston, Miami, and Seattle, within thirty months of closing the merger. <sup>105/</sup> In its Order, the Commission stated quite clearly that requiring SBC/Ameritech to compete out-of-

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<sup>103/</sup> Ironically, Qwest's ability to compete out-of-region has involved the use of access provided by AT&T and MCI – access that will likely become more costly or completely unavailable if the SBC-AT&T and Verizon-MCI deals are approved.

<sup>104/</sup> Bernheim Declaration at ¶ 33.

<sup>105/</sup> *SBC-Ameritech Merger Order*, 14 FCC Rcd 14524, 14712 (¶ 259).

region was expected to have two crucial procompetitive effects that counter-balanced the loss of potential competition between the firms. First, SBC/Ameritech out-of-region entry was expected to provide out-of-region consumers the benefits of competition. Second, out-of-region competition was expected to encourage counter-attacking competitive entry into SBC's region by other incumbent LECs:

This will ensure that residential consumers and business customers outside of SBC/Ameritech's territory benefit from facilities-based competitive service by a major incumbent LEC. This condition effectively requires SBC and Ameritech to redeem their promise that their merger will form the basis for a new, powerful, truly nationwide multi-purpose competitive telecommunications carrier. We also anticipate that this condition will stimulate competitive entry into the SBC/Ameritech region by the affected incumbent LECs. 106/

Less than a year later, as a condition on the acquisition of GTE, the Commission required Bell Atlantic (since renamed Verizon) to invest \$500 million in out-of-region entry. 107/ Once again, the Commission noted the dual benefits to be expected from this condition:

We believe that the Applicants' out-of-region competition commitment is sufficient to ensure that residential consumers and business customers outside of Bell Atlantic/GTE's territory will benefit from meaningful, facilities-based competitive service. We also anticipate that this condition will stimulate competitive entry into the Bell Atlantic/GTE region by the affected incumbent LECs. 108/

The Commission's orders were largely unsuccessful because neither SBC nor Verizon has engaged in meaningful competition out-of-region. The promises SBC and Verizon made have

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<sup>106/</sup> *Id.* at ¶ 398.

<sup>107</sup> *In re Application of GTE Corp., Transferor, and Bell Atlantic Corp., Transferee, For Consent to Transfer Control of Domestic and International Sections 214 and 310 Authorizations*, CC Docket No. 98-184, FCC 00-221, Memorandum Opinion and Order (June 16, 2000).

<sup>108/</sup> *Id.* at ¶ 321.

not been kept; SBC's and Verizon's out-of-region activities remain very limited. Qwest alone among incumbent LECs has competed aggressively out-of-region.

The record to date is clear: SBC and Verizon prefer an environment of détente or mutual forbearance, where neither materially encroaches on the other's territory, and they have avoided an environment of vigorous competition.

This merger, and the parallel Verizon-MCI merger, would make matters much worse. First, SBC and Verizon would be eliminating their most significant current competitors—who are also the greatest threat to destabilize their existing mutual forbearance. Second, having captured the large customer base and revenue of their competitors, SBC and Verizon would have even more to protect through mutual forbearance, and even less incentive to attack one another. And third, their ability to maintain detente is strengthened by the post-merger symmetry of the two companies. In short, a likely outcome of the two mergers is the creation of two enormous and durable regional monopolies. This would not happen overnight. Rather, SBC/AT&T and Verizon/MCI would allow the existing AT&T and MCI business in each other's regions to decline through reduced competition with each other, but the likely end result is clear.

Others have commented that a combined SBC/AT&T and Verizon/MCI will result in two companies so similar to one another that mutual forbearance is a likely outcome, potentially resulting in reduced price competition. For example, a recent report by Legg Mason concluded:

Finally, we reiterate our view that the enterprise sector is more sustainable should VZ prevails [as the acquirer of MCI] as VZ/MCI and SBC/T would have very similar business mixes and thus more aligned interests in the marketplace. Further, we note that with enterprise being one of many businesses in a portfolio, there would be less reliance on it, potentially leading to a moderation in the rate of price declines. Conversely, should Qwest win MCI, we see a maintenance of the significant pricing pressure in the enterprise arena as the combined company would

still be significantly reliant on the enterprise long distance business. 109/

A “White Paper” commissioned by Verizon also similarly concluded that following these deals, SBC and Verizon will “be almost mirror images of one another with similar revenues, access lines and payrolls.” 110/

That symmetry enhances the risk of tacit coordination. Symmetry, combined with each company’s regional specialization, creates a mutuality of interest, as well as a mutual threat that undoubtedly reduces their incentives to compete with one another. 111/ The only way SBC and Verizon can avoid the threat the other poses is to forego entry into the other’s region, and thereby maintain their in-region market power. Only through this mutual forbearance can they assure themselves of their continued in-region dominance. By being nearly fully self-sufficient in their own regions, and having little relative business outside their own regions, SBC and Verizon would have no self-interest in providing non-discriminatory access to their network to others on an equal footing.

No such symmetry would exist if Qwest acquires MCI. Unlike Verizon, Qwest has aggressively competed out of region. Its acquisition of MCI would continue and enhance its incentives to do so on a national and international basis.

The Commission should thoroughly evaluate the harm to the public that would occur if, through these mergers, SBC and Verizon create two durable regional monopolies. A complete investigation of their present and planned out-of-region activities is required. At this point, it

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109/ Legg Mason, *Qwest Communications Int’l., Inc. NYSE: Q, Reports Indicate Continued Q/MCI Discussions*, April 19, 2005, page 1 (emphasis added).

110/ Robert A. Saunders, *Critical Implications of the Proposed Qwest MCI Merger: An Industry White Paper* (The Eastern Management Group, 2005) at p. 2, fn.1.

111/ Bernheim Declaration at ¶ 36.

appears more likely that SBC and Verizon will reduce the vigorous competition that AT&T and MCI currently provide against the two RBOCs, rather than maintain or expand it. 112/

**VII. THE MERGER CANNOT BE APPROVED UNLESS SBC AND AT&T SUBSTANTIALLY DIVEST OVERLAPPING AT&T OPERATIONS IN THE SBC LOCAL SERVICE TERRITORY, JUST AS WOULD HAVE BEEN REQUIRED OF QWEST AND ALLEGIANCE A YEAR AGO**

Qwest already has discussed the failure of SBC and AT&T to provide any material detail regarding their overlapping operations in the SBC local service territory. That failure is grounds for rejection of this Application. However, it is important to understand why that information is needed: to evaluate the full anticompetitive effects of the merger, as well as whether remedies are possible to ameliorate that harm.

Qwest knows first hand that this information is crucial to this merger review. Just over a year ago Qwest entered into an agreement to acquire Allegiance Telecom, Inc. (“Allegiance”), a national CLEC. Allegiance operated almost entirely outside Qwest’s region, and the transaction was strategically aimed at strengthening Qwest’s ability to compete on a national basis. Unfortunately, Qwest was outbid at the bankruptcy court auction and was not able to close its deal.

Prior to the auction, however, Qwest engaged in substantial discussions with the Department of Justice Antitrust Division regarding the overlap between Allegiance and Qwest’s in-region business. Specifically, Allegiance served the business market in five (but only five) in-

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112/ Qwest’s Chairman and CEO Richard Notebaert has commented that “[t]here is nothing in these pending transactions that suggests that they will encourage either Verizon/MCI or SBC/AT&T to compete. Instead, the transactions will almost certainly reduce their need to compete by leaving them the sole contenders for long-term dominance of a market where each has substantial power.” See Richard Notebaert, Statement and slides filed with the Securities and Exchange Commission, March 15, 2005.